ECB Watch: Will I do it again, or is the hiking cycle finally ending?

September 11, 2023 6:01 CEST

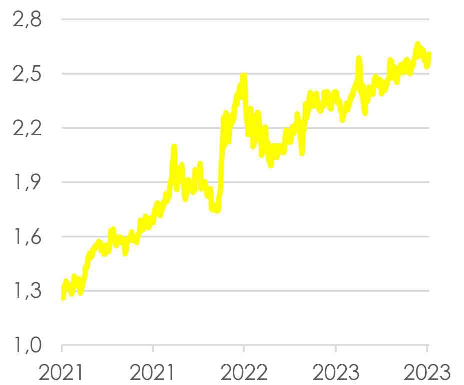
Can ECB manage to push through its tenth rate hike in a row, will the hawks in the Governing Council prevail? A rate hike on Thursday would be a (market) surprise, but is within the realm of possibility and could be argued. However, an interest rate "pause" would end the hiking cycle, in our view. The window of opportunity to push forward hikes should close soon, given economic slack in the euro area.

Hawkish consistency or dovish procrastination?

To raise key rates again this week or not, that will be the crux of the matter in the ECB Governing Council this Thursday. In principle, we see the **two options (1) last** and **tenth rate hike** in a row by 25 basis points or **(2) unchanged key rates** as almost equally likely scenarios (with a slight bias into the direction of no hike). Above all, if there will be no hike this time around, then further hikes are unlikely to be an option. The strategy of an announced pause in interest rates and a later increase does not seem credible to us in view of the rapidly deteriorating economic outlook for the euro area. For this reason, the **hawks** within ECB's Governing Council will try to add another notch to the current interest rate cycle and consistently tighten monetary policy further. Especially since the all-clear on the inflation front cannot yet be given completely, which is indicated not only by **still high price growth data**, but also by **market-based inflation expectations**.

Inflation pricing on capital markets: short & long term

5YF5Y inflation expectations: long-term forward EUR inflation swap



Source: Refinitiv, RBI/Raiffeisen Research

Source: Refinitiv, RBI/Raiffeisen Research

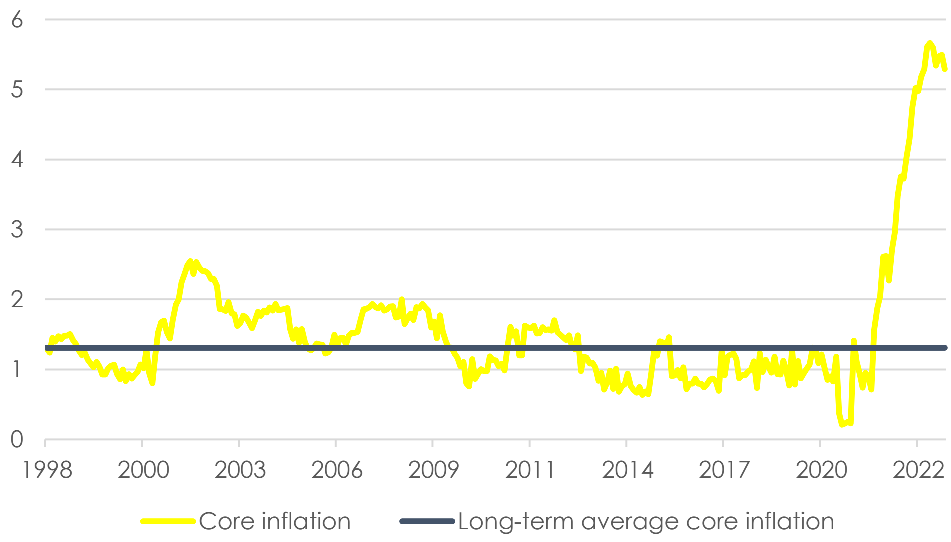
However, depending on how one looks at it, the **doves** in the Governing Council can also point to some marginal improvements in the dataset, such as the stabilization

Gunter DEUBER
Analyst Editor
+43 1 71707-5707
gunter.deuber@rbinternational.com

Gottfried STEINDL
Analyst Editor
+43 1 71707-1523
gottfried.steindl@rbinternational.com

or slight declines in core inflation. Such differentiated considerations and assessments are of particular importance considering current monetary policy decisions, which are explicitly data-driven. **ECB's own fresh forecasts** (economic growth, inflation), which will be published on Thursday, will also play a weighty role. This applies above all to the 2024 inflation forecasts. In June, the ECB projected euro area inflation at 3% in 2024 (headline and core inflation), and at 2.2% and 2.3%, respectively, in 2025 (the latter core inflation rate). However, there is a risk that core inflation will be significantly higher than headline inflation in 2024. The ECB may need to take this risk assessment into account in its projections.

Euro area: Core inflation (% yoy)



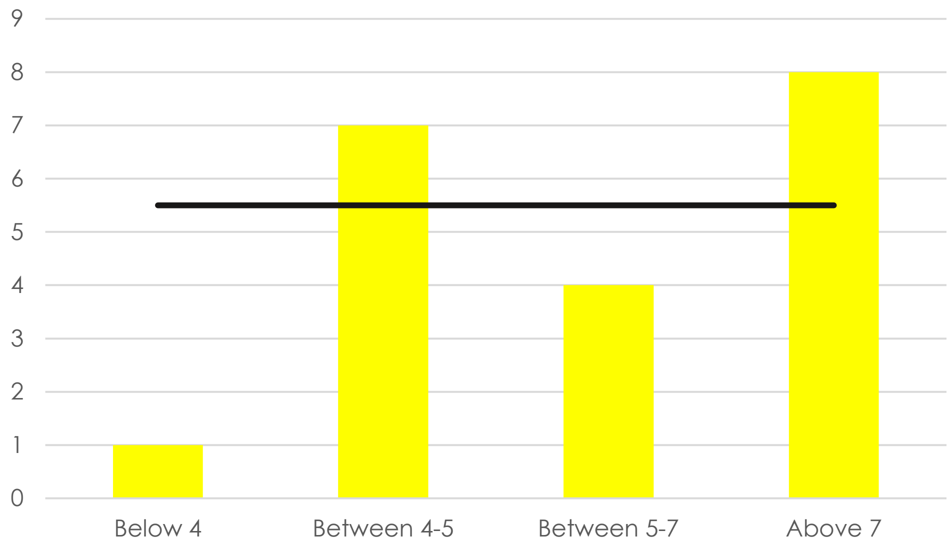
Source: Refinitiv, RBI/Raiffeisen Research

There are currently three essential criteria for data-driven decision-making at the ECB:

1) Underlying inflation: inflation rates at the euro area level have not surprised since the last interest rate meeting, which means that underlying price pressures — despite some decline in headline inflation — have only eased very slowly. At 5.3% year-on-year, **core inflation** continues to be far from ECB targets, moving only slightly away from highs around 5.5% to 5.7%. Notable easing in core inflation is possible from the turn of the year at the earliest.

2) Inflation outlook: It can be assumed that **ECB's inflation estimates** (according to June projections) will hardly change to the better. What will be important are the forecasts for core inflation, where the last ECB forecast set still painted a rather optimistic disinflation picture. Either way, inflation forecasts (headline and core inflation) should remain above ECB targets until 2025. This should be reason enough for some Council members to vote for a hike. Central bank governors from countries such as Austria, Slovakia and partly Germany have publicly positioned themselves in favor of a further hike. The fact that 8 countries in the euro area currently still have above-average inflation of over 7% (including Austria, Slovakia and Croatia) may play an indirect role here. Some forecasters even expect inflation rates above 4% in the euro area in 2024 (maximum forecast consensus 4.7%), which the ECB could interpret as a warning signal. **Market-based inflation expectations** also do not signal any easing at present and could be interpreted as a risk indicator (de-anchoring of inflation expectations).

Inflation rates euro area countries (HICP, % yoy)
Number of countries in each inflation bucket*



** Currently eight countries with inflation rates above 7%; data as of August 2023, black line euro area average inflation at 5.3% yoy*

3) Strength of monetary policy transmission: Economic data have surprised negatively since the last rate setting meeting. Fresh ECB forecasts are likely to bring a downward revision to 2023 GDP estimates (June estimate: 0.9%). Given the subdued newsflow with regard to business cycle dynamics in recent days (after the cutoff date for forecast preparation), even the lowered ECB GDP estimates are likely to be subject to downside risks. Last, **monetary indicators** should be noted. Relevant indicators point very clearly to the fact that the monetary tightening to date has led to a significant downward dynamics in the money and financial sectors. The partly negative development of outstanding money and credit will dampen economic activity and inflation with the usual time lag. After cooling considerably in recent months, almost as much as in the aftermath of the global financial crisis, euro area M3 growth was in negative territory in July for the first time since 2010, a manifest indicator of the extent of monetary tightening and drastic toughening of financing conditions. This is especially true given the role played by unwinding of unconventional monetary policy instruments, which are currently reinforcing monetary tightening and its impact on the European banking sector compared with previous interest rate hike cycles.

Does ECB seek to surprise hawkishly - or route of least resistance?

As outlined, we believe that the **upcoming ECB meeting** will bring the last "good" opportunity for a rate hike. Economic developments we expect by the end of the year (very weak economy, falling inflation, collapsing demand for credit) will quickly close the window for higher key rates. ECB will probably subsequently move to emphasize elevated / restrictive key rates for a longer period and shift the focus to other important steering instruments (balance sheet policy). On **financial markets**, an interest **rate hike is hardly expected** at present. According to the latest surveys (Bloomberg, Reuters), about half or slightly more than half of the analysts do not expect any interest rate hike or expect a pause in interest rates (51% and 55%, respectively). The EUR exchange rate movement of the last few days and weeks also does not necessarily point to interest rate fantasy in the euro area. A hike this week would be definitely a **hawkish surprise**. Thus, ECB's Governing Council will also have to consider whether it wants to be good for a certain (market) surprise once again — as it has done on several occasions in the current cycle — or not. After all, the current monetary policy cycle — despite high interest rate market volatility — has passed without any major market tensions. This could give ECB some confidence to play against interest rate expectations of market players. Moreover, in our view, **market-based inflation expectations** would even justify a rate hike. However, further rate hikes could also fuel the debate about alleged "excess profits" in the European banking sector and, from a political perspective, could again require further "compensation mechanisms". And here, ECB is not fully in line with all measures set at the national level (keyword: bank taxes).

In light of such considerations and the probably **divided opinion** in the **Governing Council**, a **non-increase** this week seems to us rather the **dominant strategy** from a **political economy perspective**. Overall, the decision of not raising rates this time should be rather an easy one to take. This would then be the starting signal for the important next debate in the Governing Council: High key rates for how long, falling key rates from when?

Disclosure

Risk notifications and explanations

Warnings:

- Figures on performance refer to the past. Past performance is not a reliable indicator for future results and the development of a financial instrument, a financial index or a securities service. This is particularly true in cases when the financial instrument, financial index or securities service has been offered for less than 12 months. In particular, this very short comparison period is not a reliable indicator for future results.
- Performance of a financial instrument, a financial index or a securities service is reduced by commissions, fees and other charges, which depend on the individual circumstances of the investor.
- The return on an investment in a financial instrument, a financial or securities service can rise or fall due to exchange rate fluctuations.
- Forecasts of future performance are based purely on estimates and assumptions. Actual future performance may deviate from the forecast. Consequently, forecasts are not a reliable indicator for future results and the development of a financial instrument, a financial index or a securities service.

A description of the concepts and methods used in the preparation of financial analyses is available under: **www.raiffeisenresearch.com/concept_and_methods**.

Detailed information on sensitivity analyses (procedure for checking the stability of potential assumptions made in the context of financial analyses) is available under: **www.raiffeisenresearch.com/sensitivity_analysis**.

Disclosure of circumstances and interests which may jeopardise the objectivity of RBI: **www.raiffeisenresearch.com/disclosuresobjectivity**.

Detailed information on recommendations concerning financial instruments or issuers disseminated during a period of 12 month prior to this publication (acc. to Art. 4 (1) i) Commission Delegated Regulation (EU) 2016/958 of 9.3.2016) is available under: **https://raiffeisenresearch.com/web/rbi-research-portal/recommendation_history**.

IMPORTANT LEGAL NOTICE

By opening and/or using the information, services, links, functions, applications or programmes (hereinafter: "contents"") offered on this website, the user hereby agrees to be bound by the terms and conditions set out below:

Copyright law

The contents offered on this website and subsites (hereinafter: the “RBI Research-Website”) are protected by copyright law. The downloading or storage of applications or programmes contained on the RBI Research-Website and the (complete or partial) reproduction, transmission, modification or linking of the contents of the RBI Research-Website shall only be permitted with the express and written consent of Raiffeisen Bank International AG ("RBI"").

Information content, timeliness of information

The contents of the RBI Research-Website you are seeking to access is for information only and does neither qualify as investment advice nor constitute or form part of any offer to buy or sell any securities or other financial instruments as defined in Article 5 para 1 number 15 of EU Directive 2014/65 (“MiFID II”) in any jurisdiction or jurisdictions, (and must not be considered in any way as an offer or sale in relation to any securities or other financial instrument). In particular, no securities have been or will be registered under the United States Securities Act of 1933, as amended (the “Securities Act”), and no such securities may be offered or sold in the United States absent registration or exemption from registration under the Securities Act.

RBI has made every effort to ensure reliability in researching the information published on the RBI Research-Website or sent via RBI Research-Website as well as in selecting the source of information used. Nonetheless, RBI does not assume any liability whatsoever for the correctness, completeness, timeliness or uninterrupted availability of the information made available on the RBI Research-Website or as regards the sources of information used.

The information contained on the RBI Research-Website as well as forecasts published on the RBI Research-Website are based on the information available and the market assessment at the point in time stated in the respective publications. Certain information on this website constitutes forward-looking statements. RBI does not assume and hereby as far as possible expressly excludes any liability for the correctness, completeness or actual occurrence of the events described in the forward-looking statements. Such statements are not guarantees of future performance and involve a number of risks, uncertainties and assumptions. Certain financial data (e.g. stock exchange prices) may in some cases only be published after a certain interval of time has lapsed as defined by the data vendor (usually about 15 minutes or previous day end-of-day quotes). Furthermore, please note that many of the times are given in Greenwich Mean Time (GMT).

You agree and acknowledge that the information and statements contained in the materials you are accessing on the RBI Research-Website speak only as of the date of such document and such information and statements will become inaccurate, stale and/or out-of-date thereafter. These materials should not be relied upon at any time for any investment decision.

RBI assumes no responsibility to maintain documents posted on the RBI Research-Website or to update any documents. Therefore, users of the RBI Research-Website acknowledge that the content of documents available on the RBI Research-Website may not show the most recent scenarios, analysis or conclusions.

Restricted access due to local regulations

Users of the RBI Research-Website can access some documents and information without registration requirements and without further barriers (the respective area on the RBI Research-Website is hereinafter referred to as “Unrestricted Area”). By accessing the Unrestricted Area, you agree and acknowledge that the materials on the RBI Research-Website may lawfully be made available in accordance with the laws of the jurisdiction in which you are located.

Other documents are only available to persons who have registered themselves in accordance with the required procedure. The part of the RBI Research-Website which can only be acceded by way of registration is hereinafter referred to as “Restricted Area”).

Due to the laws applicable in some jurisdictions or regulations imposed by capital market or securities authorities, some of the information published on the RBI Research-Website (e.g. stock analyses) is not addressed to private individuals. In order to ensure the enforcement of such local access restrictions, RBI retains the right to take any (technical) measures it may deem suitable for restricting such information or segments of information subject to the aforementioned restrictions. The passing on of information contained on the RBI Research-Website, which is subject to local access restrictions valid in certain countries, to the persons stated in the relevant restrictions may constitute a breach of securities law or of other laws of said countries.

The distribution or dissemination of information published on the RBI Research-Website as well as the purchase and offering of the respective products in certain jurisdictions may be subject to restrictions or additional requirements. Persons who retrieve such information from the RBI Research-Website or into whose possession such information comes are required to inform themselves about and to observe such restrictions. In particular, the products to which such information published on the RBI Research-Website refers, may generally not be purchased or held by U.S. persons (the term “U.S. person” refers to any legal/natural person having its seat/residence in the U.S.A and any other person within the meaning given to it by Regulation S under the Securities Act 1933 as amended).

Users of the Unrestricted Area should be aware that the documents available on this part of the RBI Research-Website are not made available on the basis that any customer relationship is created between RBI and such user solely on the basis of such user having access to the respective documents. The documents available in the Unrestricted Area are intended to be available to users in the European Economic Area and in the United Kingdom.

Links to websites or URLs of third-party providers

With the exception of the cases regulated under § 17 of the Austrian E-Commerce Act, RBI does not assume any liability for the content of websites or URLs of other providers to which links are provided. Neither does RBI assume any liability for the uninterrupted availability or full functionality of the links to websites or URLs of third parties.

Exclusion of liability

RBI makes no warranty and will accept no liability for any damages whatsoever (including consequential or indirect damages, or lost profits) relating to the access to the RBI Research-Website, the opening, use or querying of the contents on the RBI Research-Website or relating to the links set up on the RBI Research-Website to websites or URLs of third parties. This applies also in cases in which RBI points out the possibility of incurring such damages.

Furthermore, RBI shall not be liable for technical disruptions such as server breakdowns, operating disruptions or failures of the telecommunications links and other similar events, which could lead to the (temporary) unavailability of the RBI Research-Website as a whole or parts of it.

Storage of registration data

The content in the Restricted Area of the RBI Research-Website is only available to registered users. By sending the completed online registration form, the user confirms the completeness and correctness of the data given and also confirms having truthfully answered the questions asked. Furthermore, by sending the completed online form, the user hereby declares his or her consent to the electronic processing of his or her registration data by RBI for both internal banking organisational purposes and for transmission to other credit institutions within the Raiffeisen Banking Group, which may in turn also process, pass on or use such data.

Changes to the RBI Research-Website

RBI retains the right to change and to remove the RBI Research-Website at any time (if necessary also without prior notice), in particular as regards changing existing contents (in full or in part) and adding new contents.

General terms and conditions of business

For (authorised) users who use the services of RBI provided on the RBI Research-Website, the General Terms and Conditions of Business, as amended, of RBI shall apply in addition to the terms and conditions of this Disclaimer.

Please also take note of the general information provided pursuant to § 5 of the E-Commerce Act!

Thomas SternbachLegal and ComplianceRaiffeisen Bank International AGAm Stadtpark 9, 1030 WienTel: +43-1-71707-1541Fax: +43-1-71707-761541thomas.sternbach@rbinternational.com

IF YOU CANNOT SO CERTIFY, YOU MUST CLICK THE BUTTON LABELLED “I DECLINE” OR OTHERWISE EXIT THIS WEBSITE.

BY ACCESSING THE MATERIALS ON THIS WEBSITE, YOU SHALL BE DEEMED TO HAVE MADE THE ABOVE REPRESENTATIONS AND CONSENTED TO DELIVERY BY ELECTRONIC TRANSMISSION.

This document is a marketing communication.

Contacts

FABIAN BLASCH
Austria ,
fabian.blasch@rbinternational.com

GUNTER DEUBER
Austria ,
gunter.deuber@rbinternational.com

CASPER ENGELEN
Austria ,
casper.engelen@rbinternational.com

AMADEA HIESS
Austria ,
amadea.hiess@rbinternational.com

MATTHIAS REITH
Austria ,
matthias.reith@rbinternational.com

GOTTFRIED STEINDL
Austria ,
gottfried.steindl@rbinternational.com

MARKUS TSCHAPECK
Austria ,
markus.tschapeck@rbinternational.com

FRANZ ZOBL
Austria ,
franz.zobl@rbinternational.com

BRISIDA BUZI
Albania ,
Brisida.BUZI@raiffeisen.al

VALBONA GJEKA
Albania ,
valbona.gjeka@raiffeisen.al

FJORENT RRUSHI
Albania ,
Fjorent.Rrushi@raiffeisen.al

ARISTEA VLLAHU
Albania ,
Aristea.Vllahu@raiffeisen.al

OLGA ZHEGULO
Belarus ,
olga.zhegulo@priorbank.by

ASJA GRDJO
Bosnia Herzegovina ,
asja.grdjo@raiffeisengroup.ba

IVONA ZAMETICA
Bosnia Herzegovina ,
ivona.zametica@raiffeisengroup.ba

MIRZA ZORNIC
Bosnia Herzegovina ,
mirza.zornic@raiffeisengroup.ba

ELIZABETA SABOLEK-RESANOVIC
Croatia ,
elizabeta.sabolek-resanovic@rba.hr

ZRINKA ZIVKOVIC-MATIJEVIC
Croatia ,
zrinka.zivkovic-matijevic@rba.hr

HELENA HORSKA
Czech Republic ,
Helena.Horska@rb.cz

LEVENTE BLAHÓ
Hungary ,
levente.blaho@raiffeisen.hu

GERGELY PÁLFFY
Hungary ,
gergely.palffy@raiffeisen.hu

ZOLTÁN TÖRÖK
Hungary ,
torok.zoltan@raiffeisen.hu

DOROTA STRAUCH
Poland ,
dorota.strauch@raiffeisen.pl

NICOLAE COVRIG
Romania ,
Nicolae.Covrig@raiffeisen.ro

ANDREEA-ELENA DRAGHIA
Romania ,
Andreea-Elena.DRAGHIA@raiffeisen.ro

IONUT DUMITRU
Romania ,
Ionut.Dumitru@raiffeisen.ro

ANASTASIA BAYKOVA
Russia ,
ABAIKOVA@raiffeisen.ru

GREGORY CHEPKOV
Russia ,
grigory.chepkov@raiffeisen.ru

STANISLAV MURASHOV
Russia ,
stanislav.murashov@raiffeisen.ru

LJILJANA GRUBIC
Serbia ,
ljiljana.grubic@raiffeisenbank.rs

TIBOR LORINCZ
Slovakia ,
tibor_lorincz@tatrabanka.sk

SERHII KOLODII
Ukraine ,
serhii.kolodii@raiffeisen.ua

OLEKSANDR PECHERYTSYN
Ukraine ,
oleksandr.pecherytsyn@raiffeisen.ua

Imprint

Information requirements pursuant to the Austrian E-Commerce Act

Raiffeisen Bank International AG Registered Office: Am Stadtpark 9, 1030 ViennaPostal address: 1010 Vienna, Postfach 50Phone: +43-1-71707-1846Fax: +43-1-71707-1848

Creation time of this publication: 11/09/2023 6:01 A.M. (CEST) ;
First Dissemination of this publication: 11/09/2023 6:01 A.M. (CEST)

Company Register Number: FN 122119m at the Commercial Court of ViennaVAT Identification Number: UID ATU 57531200Austrian Data Processing Register: Data processing register number (DVR): 4002771S.W.I.F.T.-Code: RZBA AT WW

Supervisory Authorities: As a credit institution (acc. to § 1 Austrian Banking Act; Bankwesengesetz) Raiffeisen Bank International AG is subject to the supervision by the Austrian Financial Market Authority (FMA, Finanzmarktaufsicht) and the National Bank of Austria (OeNB, Oesterreichische Nationalbank). Additionally, RBI is subject to the supervision by the European Central Bank (ECB), which undertakes such supervision within the Single Supervisory Mechanism (SSM), which consists of the ECB and the national responsible authorities (Council Regulation (EU) No 1024/2013 - SSM Regulation). Unless set out herein explicitly otherwise, references to legal norms refer to norms enacted by the Republic of Austria.

Membership: Austrian Federal Economic Chamber, Federal Bank and Insurance Sector, Raiffeisen Association.

Statement pursuant to the Austrian Media Act

Publisher and editorial office of this publication Raiffeisen Bank International AGAm Stadtpark 9, A-1030 Vienna**Media Owner of this publication**Raiffeisen RESEARCH – Verein zur Verbreitung von volkswirtschaftlichen Analysen und FinanzmarktanalysenAm Stadtpark 9, A-1030 Vienna**Executive Committee of Raiffeisen RESEARCH – Verein zur Verbreitung von volkswirtschaftlichen Analysen und Finanzmarktanalysen:**Mag. Gunter Deuber (Chairman), Mag. Helge Rechberger (Vice-Chairman)Raiffeisen RESEARCH – Verein zur Verbreitung von volkswirtschaftlichen Analysen und Finanzmarktanalysen is constituted as state-registered society. Purpose and activity are (inter alia), the distribution of analysis, data, forecasts and reports and similar publications related to the Austrian and international economy as well as financial markets.**Basic tendency of the content of this publication**

- Presentation of activities of Raiffeisen Bank International AG and its subsidiaries in the area of conducting analysis related to the Austrian and international economy as well as the financial markets.
- Publishing of analysis according to various methods of analyses covering economics, interest rates and currencies, government and corporate bonds, equities as well as commodities with a regional focus on the euro area and Central and Eastern Europe under consideration of the global markets.

Producer of this publication Raiffeisen Bank International AGAm Stadtpark 9, A-1030 Vienna